



Loss Prevention Risk Finance Section

Office of Financial Management

Risk Management Division Guidelines for Section 12.1 – Risk Management and Self-Insurance Premiums 2007-09 Budget

Purpose and Use

These guidelines are provided to help agency risk managers and financial personnel prepare the Risk Management and Self-Insurance Premium budget decision package. The general information and references to other sections of the budget guidelines are included to help agencies shape a more *enterprise risk management*-based document for the Section 12.1 section of the budget document. In addition, section B provides a glossary of key terms used in addressing risk management overall and *enterprise risk management* in particular.

Management of agency risk is both an operational and strategic activity for agencies. Each agency faces unique risks, but also shares common risks with other agencies. *Enterprise risk management*—as a practice—requires agencies to address both aspects of its risk. It also requires allocating resources based on performance measures and risk strategies across the “*enterprise*” of the program, the agency, and the state as a whole by using an integrated approach to address the root cause of risk.

A. Why is Section 12.1 a Policy and Performance Level Package?

(Reference: *Budget Instruction 6.1*)

Enterprise risk management represents a revised strategy for the state as a whole, as it requires agencies to report on the management of risk not just in terms of loss prevention and control related to possible liability scenarios, but in terms of management of *all risk to the agency's mission*.

The policy and performance level package allows agencies to explain aspects of new programs or services, and changes to existing programs, in relation to the agency's management of its total risk. The *enterprise maturity model* developed by OFM's Risk Management Division may be a helpful tool in identifying possible areas for discussion

and reference. It's a tool that helps agencies inventory their status in incorporating an enterprise risk management approach in business plans and operations. The Risk Management Division's risk specialists have been meeting with agency risk managers to prepare maturity model rankings. Consult with your agency risk manager (contact) for more information about the enterprise risk management maturity model and how it is applied in your agency.

In addition, a listing of agencies and their assigned risk specialist is available on the Risk Management Division budget web page at <http://www.ofm.wa.gov/rmd/budget/default.asp>. Agencies are encouraged to contact their risk specialist for information about the risk management budget instructions, loss history data, or other general risk management questions.

The policy and performance level package provides the platform to explain the agency's desired program design and needs, particularly if there is no existing risk management program. The amount of the self-insurance premium assessed by OFM for each agency is posted on the website address noted above. Section 12.1.1, requires that the previous (2003-05), current (2005-07), and upcoming biennia (2007-09) be included in the decision package narrative.

B. Risk Management Glossary

The following glossary provides a review of key terms commonly used in managing risk, and also may be useful in understanding the *enterprise risk management* concept and how its principles can be incorporated into the agency's budget document.

Risk

Risk can be created by any event or outcome that has the potential to interfere with an agency's ability to achieve its mission.

Enterprise Risk Management

The discipline and its associated processes of applying a risk evaluation to each agency activity and outcome, identifying root causes of unanticipated or unwanted outcomes or potential outcomes, and determining—as an enterprise—what changes are best to address the root cause, and then monitoring the success of the mitigation strategy. Mitigation strategies can include:

- Transferring the risk
- Minimizing the negative outcome
- Preventing the outcome
- Eliminating the activity associated with the risk

For example, insurance transfers the possible cost of risk to the insurance company. An early resolution program minimizes the cost of negligence by resolving claims before they become lawsuits. Changing a policy and procedure so that employees know what to do in certain situations can prevent negative outcomes. Abandoning an activity that had resulted in injury eliminates the risk posed by the activity.

Enterprise Risk Management Maturity Model

A measurement tool used by the Risk Management Division to help agencies assess their progress towards implementing an enterprise risk management approach by evaluating agency infrastructure and programs. The model elements also help agencies set risk management goals and recognize achievements. *Note: Contact your agency risk manager for more information about the rating completed for your agency.*

Loss History

OFM defines loss history as the information received by OFM from the agency, or developed and maintained by the agency at OFM's direction, in order to administer the management of a material risk. OFM's risk management information system contains records of reported incidents, and filed tort claims and lawsuits. The data contained in this system is used to compile reports that detail agency loss.

Risk Appetite

Is the amount of risk that an organization is prepared to accept or be exposed to. Risk appetites are often referred to as high, medium, or low. But actually, the analysis of risks by an agency includes deciding at what level of outcome the benefit from addressing the risk outweighs the cost of addressing it. In addition, if a program has inherent risks, then having a high-risk appetite and managing the financing of the risk often becomes the risk management strategy. A high-risk appetite is unavoidable for organizations performing inherently dangerous activity or an activity involving the behavior of third parties.

Risk Assessment

Is the process of identifying risk, its root causes, and potential outcomes. This takes place before risk mapping.

Risk Mapping

Is the exercise of listing key risks for the agency as an enterprise, and for each program, and mapping the risks by frequency and severity. The risk management strategies to address high frequency-high severity risks should be addressed in the agency's budget decision package.

Self-Insurance Premium

Is the premium paid by an agency to the OFM Risk Management Division to fund the State of Washington Self-Insurance Liability Program (SILP) and for its share of the excess insurance premium. SILP pays general liability indemnity, auto liability indemnity and tort defense costs.

C. Decision Package Description of the Costs and FTEs by Activity

(Reference Budget Instruction 2.3)

In the purest sense, “risk management” is “good management”. For this reason, other budget items also support an agency’s risk management activity. For example, training of supervisors and managers in employment law is a risk management activity that helps prevent employment practices liability. Information systems security software and personnel perform a key risk management activity for the agency in addressing its data security risks. The risk management budget package should cross-reference to these items appearing elsewhere in the budget submittal, and demonstrate the additional cost-benefit of the resource allocation in terms of its risk management benefit.

The risk budget package should also include the delineation of the FTEs working on risk issues. Use the agency’s risk map to help identify FTEs that are helping manage risk as part of their daily assignment, even if they are not formally designated as “risk managers.” For high frequency/high severity programs, often a material percentage of certain employee functions are spent addressing risk. Referencing this is recommended for your decision package.

D. Decision Package Presentation of Performance Measures Related to Risk Management Activity

(Reference Budget Instruction 9.1)

Section 9.1 of OFM’s budget instructions references RCW 43.88.090, and directs agencies to propose at least one performance measure for every major activity. As agencies develop performance measures, a performance measure related to risk management activity within the agency should be considered.

It is quite likely that many outcome measures of key agency mission related activities would also satisfy risk management criteria. Those performance measures should be referenced in section 12.1, with an explanation of the risk they address and its frequency/severity.

Additional options for risk management related performance measures include:

<p>Cost of Risk is a clear measure of the effectiveness of the overall agency risk management program</p>	<p>Cost of Risk</p> <p>The Cost of Risk measure can be based on the total cost of risk divided by the number of FTE's, or as a percentage of the agency's operating budget. Targets should link to agency areas of opportunity to improve risk management.</p> <p>The Annualized Cost of Risk could include:</p> <ol style="list-style-type: none"> Worker compensation costs Commercial insurance premium State Tort Liability Self-insurance premium Risk management administrative fee State Auto Liability Self-Insurance premium Defense costs for insured and uninsured litigation Risk manager and related staff overhead Indemnity payments Non-indemnity payment to resolve claim, litigation, grievance or administrative hearing matters. Property losses (insured and uninsured) Fines or financial penalties related to compliance with rules, regulations or contractual obligations Safety and health (not benefits) programs (employees, clients, visitors) Risk training costs Internal audit and quality program staff overhead
	<p><i>Note: Agencies can develop the performance measure in several ways. One way is to apportion the cost of risk per FTE and then trend the statistic to determine whether the cost of risk is increasing or decreasing. Alternatively, agencies can track the cost of risk as a percentage of the total budget, and strive to achieve a percentage in alignment with the agency risk appetite.</i></p>

<p>Enterprise Risk Management is the discipline of managing risk across an agency, and integrating risk recognition, assessment, mitigation and monitoring of the effectiveness of the change into the agency's operating practice.</p>	<p>Development of Enterprise Risk Management Infrastructure <i>(See section 4 of Budget Instruction 12.1)</i></p> <p>As mentioned earlier, the risk management maturity model is a tool agencies may want to refer to in developing their risk management strategies. The agency risk manager (contact) can provide information about the rating completed for the agency.</p> <p>The following are enterprise risk management-based statements that agencies may wish to explore or consider in preparing their risk management recommendations.</p> <ul style="list-style-type: none"> • A risk review is used as part of the budget development analyzing resource allocation in terms of the agency enterprise risk management program. • Director/Secretary has issued a risk management policy defining ERM as a strategic practice of the organization. • A cross-functional or multi-program risk assessment, resource or management team meets monthly to evaluate incidents, and recommend action. • Strategic risk elements are built into existing processes. • Agency periodically evaluates and adjusts its risk management program for quality and results. • Risk management is integrated within the organization. • Agency GMAP measures relate to outcomes that include loss prevention, loss control or efforts to manage risk. • Each agency program performs annual risk mapping and assessment. • Incident reports are evaluated at regular intervals, and data is shared with executive and senior management. • Incidents are evaluated using varying levels of analysis based on the severity of the outcome or potential outcome. • Programs have a practice and process for changing based on root cause analysis of identified incidents. • The agency views risk as encompassing more than claims and litigation prevention.
--	--

E. Addressing Loss History in the Decision Package

(Reference Budget Instruction 12.6)

The loss history (claims experience) is used by the State's actuary to develop the funding requirements for the Self-Insurance Liability Program account. Agencies are assessed a premium based on their individual loss history for the prior five years. Explaining the agency's loss history and the steps put into place to improve it, is "core" to Section 12-budget decision package for risk management.

<p>OFM will provide loss history reports to agencies. Visit the OFM website to place an on-line report order.</p>	<p>Agencies are expected to use the loss history report to help discuss risk experience both as to frequency and severity, and to tie the lessons learned from that analysis to their strategic plan, operational goals and performance measures and other material aspects of their budget.</p> <p>To Obtain Loss History Reports Via The Risk Management Division Website go to.... http://www.ofm.wa.gov/rmd/budget/lossreport.htm</p> <p><i>Important Note:</i> <i>Loss history is privileged and confidential pursuant to RCW 43.41.350(3). Agencies should discuss any specific losses on a "de-identified" basis. Questions regarding this can be directed either to the agency's assistant attorney general, or the agency's OFM risk specialist.</i></p>
--	--

Loss History Report Requests	<p>The report will include:</p> <ul style="list-style-type: none"> ▪ The agency’s claim and litigation experience in payouts and defense costs based on losses occurring from July 1, 1999 to December 31, 2005. Other time periods can be requested if desired. ▪ Report types are described on the website and agencies may choose to order one or all of the reports listed. ▪ <u>Note:</u> The “Filed Claims Report” spreadsheet report is best suited for the risk analysis of small agencies or agencies with few tort claims.
Use of Loss History Reports	<p>When addressing past and future loss history trends, agencies will need to prepare a risk assessment of their key risks, and analyze whether the experience demonstrated by the loss history is consistent with their experience. The loss history can also be used to identify “emerging” risks.</p>
Protect Confidential or Private Information	<p>When discussing goals, measures, accountability projects or outcomes related to systems, process, practices and programs, agencies must de-identify information so that the names of claimants or employees are not mentioned in the budget document.</p>

F. Risk Analysis Topics for Goals and Measurement

(Reference Budget Instruction 12.7)

The budget instructions ask agencies to include a discussion of areas of risk for analysis, goals and measurement.

To analyze risk, as well as establish goals and measurement of outcomes related to those goals, risks must be consciously—and in a disciplined way—assigned priorities for addressing those risks. Take employment practices liability as an example. One agency may need to focus on employment practices liability as related to a shrinking available and qualified workforce, necessitating salary and training enhancements. Another agency may need to focus on preventive training and policy/procedure review to address a rise in employee lawsuits.

The areas of risk set forth below are areas that every agency should be addressing in addition to any risk sets unique to the agency.

Loss Prevention Review Team	<p>If an agency program has been reviewed under RCW 43.41.370, and an implementation plan is prepared or in process, the implementation plan can be discussed in regard to</p> <ul style="list-style-type: none"> • the area of risk analyzed by the loss prevention review team • the agency's goals, needs and measurement standards for addressing the root causes of the risks identified by the team. <p>Agencies can also provide their definition of incident, and the incident reporting system or process in place, as well as the agency's goals for analyzing incidents, and measure whether mitigation and control efforts are working.</p>
Employment Practices Liability	Agencies should address risk associated with labor relations, specific causes of action experienced, unique workforce elements, skill-sets and capacity, and its DOP scorecard experience tied to management goals and tort experience.
Safe Driving	Numbers and values of state vehicles (owned by agency or available through the state motor pool) used by employees compared to total agency FTE analyzed based on miles driven, and accident history. It could be expanded to all accident history such as employees driving on state errands in POVs. Discuss the safe driving program in place in the agency. If 12 or 15-passenger vans are used, discuss whether a phase-out program has been initiated, and state whether the vans will be used for purposes other than on-campus (if applicable) transport of equipment or passengers.
Program Liability	Discuss the top five risks posed by program operations, management of those risks, and the frequency and manner of monitoring it as to effectiveness.
Reputational Risk	Discuss the strategy used to address the agency's key areas of reputation risk, including methods to limit the potential impact to the agency. Include a discussion of communication plans for high profile incidents, whether internal controls are in place and can be referenced in the event of fidelity or similar related financial incidents, and whether the agency understands how to use the "expressions of regret" legislation to minimize reaction to incidents.

Threat Assessment and Response	Discuss the agency's program to identify external emergency, natural disaster, terrorist or other violent criminal activity risk and response, and the agency's plans for protection of its employees, property and key systems, as well as for business continuity.
Safety and Worker Compensation Management	Discuss the agency's organizational structure and activities for maintaining a workplace safety and health program, and any additional activities if enrolled in the L&I retrospective rating program. Address whether the agency program complies with the Washington L&I Division of Occupational Safety and Health (DOSH) requirements for work environments and with Department of Personnel rules on return-to-work. Describe the agency programs to evaluate and reduce workplace injuries, occupational illnesses and other workplace incidents. Describe the agency's worker compensation claim monitoring system, and its time-loss experience.
Accreditation, Audit, Contracts, Data Security, Incident Program, Quality programs, Training and other Global Mitigation Strategies	Describe the risk mitigation tools and processes used by the agency across its enterprise or within a specific program to protect the agency's resources from internal and external harm, breakdown, unexpected depletion or interruption. Specifically address the agency's contract management program, its data security program, and incident program, in addition to any other efforts related to risk management that benefit the enterprise.
Financial Risk	Discuss internal controls, compliance programs for externally funded requirements, major areas of financial risk, and if there were financial audit findings, the agency's risks and strategies associated with achieving its corrective action plan.